

***Michael C. Schlachter, CFA
Managing Director & Principal***

July 25, 2011

Dr. Louis Moret
Chair, Investment Policy Subcommittee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Revision of RMARS Policy

Dear Dr. Moret:

You requested Wilshire's opinion with respect to the proposed revisions to the RMARS policy.

Recommendation

Staff has determined that the Absolute Return Strategies program, formerly the Risk Managed Absolute Return Strategies program, should be located outside of Global Equities, directly reporting to the CIO. This new organizational structure, the funding source for ARS, the removal of "Risk Managed" from the title of the program, and the way in which the portfolio will be benchmarked at the Total Fund level are all questions that the Investment Committee or Investment Policy Subcommittee needs to discuss with Staff.

The proposed policy also increases liquidity in the portfolio, a point with which we agree, and increases the maximum allowable amount in hedge fund investments, another point that we believe should be fully discussed.

Discussion

As noted above, Staff has decided to move RMARS / ARS out of Global Equity into a new structure that reports directly to the CIO. As a result, a new policy is required that addresses the issues that this raises.

First, Staff has proposed that additional allocations to hedge fund investments should be funded from both fixed income and equity investments, whereas formerly RMARS was funded solely from Global Equities. This is a significant change that could alter the



risk profile of the CalPERS portfolio if a large amount of money is moved from lower-risk fixed income into hedge fund investments.

Second, Staff has proposed changing the name of the program to remove the reference to "Risk Managed". While we doubt that this will have a meaningful impact on the way that the portfolio is actually managed, this does signal a change in the core intent of the portfolio. While we do not object to this change, the committee should be given the opportunity to discuss if this is what is really wanted.

Third, Staff has proposed not including the RMARS / ARS benchmark in the Total Fund benchmark. This is a de facto change from the current Total Fund benchmark, which has a static weight of 2.5% to hedge funds (5% of Global Equities), and will shift hedge funds to an "out of benchmark" position. Given the illiquidity of hedge funds, this will cause outperformance and underperformance at the Total Fund level to be due as much to market movements as to portfolio management skill.

Please let us know if you have any questions or comments.

Best regards,

A handwritten signature in black ink, appearing to read 'Michael A. ...'.